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Report to the Chairman, Committee on
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Transportation, U.S. Senate

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FOREIGN INVESTMENT

Critique of Treasury Report on Major Industrial Countries Restrictions





United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

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The Honorable Ernest F. Hollings
Chairman, Committee on Commerce,
Science, and Transportation
United States Senate

Dear Mr. Chairman:

This report responds to your July 20, 1989, request that we critique the December 1988 Treasury Department survey of the Group of Seven (G-7)¹ countries' laws and regulations governing foreign direct investment. Also, as requested, this report compares the provisions of the proposed Foreign Ownership Disclosure Act of 1989 (S.289) to G-7 practices.

Results in Brief

In general, the Treasury Department report, Survey of G-7 Laws and Regulations on Foreign Direct Investment, accurately describes the laws and regulations which G-7 countries have in place governing foreign direct investment inflows. However, descriptions of formal requirements alone do not fully characterize a country's investment climate. Informal restrictions or barriers can also be strong deterrents to prospective foreign investors.

Treasury's G-7 Report

Treasury focused its report on the G-7 countries' formal requirements governing foreign direct investment inflows. It specifically listed laws and requirements in three broad categories.

1. Notification, screening, and blocking procedures category, which describes the formal procedures governing foreign direct investments in these countries.
2. Reporting and disclosure requirements category, which describes and notes whether the governments maintain registries of foreign investments or publicly disclose foreign investment information.

¹The Group of Seven includes the United States, Canada, the United Kingdom, France, Germany, Italy, and Japan.

3. Sectoral restrictions category, which describes restrictions on foreign investments in certain sectors due to national security and other reasons, such as public order and safety.

In preparing its report, Treasury relied on (1) information requested from U.S. financial attaches at embassies in G-7 countries (generally Treasury personnel), (2) investment climate statements prepared by the Department of State, and (3) Organization for Economic Cooperation and Development documents from its Committee on Capital Movements and Invisible Transactions and its Committee on International Investment and Multinational Enterprises. The report did not undergo a formal interagency clearance process, although Treasury stated it sent the report to selected agencies. Information on the United States was developed from Treasury files on U.S. laws and regulations. We discussed the report with officials of the Departments of Commerce and State and the Office of the U.S. Trade Representative, which also cover international investment issues, and they generally concurred with the information it contained.

The Treasury report's focus on formal investment requirements was meant to provide background information relating to pending congressional legislation to strengthen formal U.S. requirements governing foreign direct investment in the United States. Treasury noted that its report did not attempt to catalog cultural or institutional impediments to foreign direct investments. Treasury also did not include discussion of Trade-Related Investment Measures (TRIMs), such as export and local content requirements, which can affect investment flows and are currently being addressed in the Uruguay Round of the General Agreement on Tariffs and Trade.

We reviewed the Treasury report and the documents used in preparing it and did not find discrepancies between the report and the information on which it was based. However, the level of detail in the description of U.S. regulations was greater than that for other G-7 countries and included, for example, regulations governing foreign investments in defense classified facilities, which are likely also to exist in other G-7 countries. There were a few data items in the report for which there was no documentation in the Treasury files used in preparing the report.

Informal Investment Barriers

The distinction between a country's formal investment requirements and the informal restrictions facing foreign investors can be important, and descriptions that focus on formal requirements do not fully characterize the actual investment climates in some countries. In addition, TRIMs, whether formal or informal, are important in describing a country's investment climate.

To obtain information on the overall investment climate in three G-7 countries—Japan, France, and Canada—that have recently liberalized their formal requirements, we examined country files at the Departments of State and Commerce and interviewed country desk officers. Our specific focus was to determine what recent U.S. investor experiences have actually been. The principal types of informal impediments facing U.S. investors that we identified from this limited inquiry are summarized below.

Japan

Japan is the G-7 country which is perceived as having the most informal impediments to investments. Japanese business culture and practices, which entail a number of significant differences from those in the United States, result in informal barriers for foreign investors. These informal barriers include the fact that Japanese companies are rarely sold, there are virtually no hostile takeovers, and cross-shareholding among allied companies results in a low percentage of a company's common stock being available for sale on the stock market. In addition, Japan's long-term employment and supplier relationships, close ties between government and industry, and complex distribution system are considered formidable barriers. The U.S. business community also considers weak trademark and service mark protection and ambiguous licensing procedures as barriers to foreign direct investment in Japan. The Japanese patent and copyright systems are also regarded as barriers, due to the slowness of registration procedures, processing logjams, and patenting criteria that protect products having minimal changes. Even though Treasury's report emphasizes the liberalization of Japan's formal restrictions and resulting official openness to foreign investment, the report notes that institutional and cultural impediments contribute to Japan's "relative impermeability" to foreign investment.

France

Investors outside the European Community must obtain prior French government approval when seeking to acquire French firms valued at 10 million French francs or more (about \$1.5 million as of September 1989). The Treasury report stated that recent investor applications had been

only rarely denied. Although no formal restrictions have since been added to French government regulations on inward investment, U.S. investors have experienced greater difficulties in acquiring French firms during the past year. In several instances, French government decisions were delayed until the U.S. investor made commitments in suggested areas (such as employment, export levels, and sourcing of inputs) or until a French buyer appeared, sometimes with the encouragement of government officials. U.S. government officials have made representations to the French government about these difficulties and about the lack of transparency in the French approval process, which permits lengthy and unexplained delays and denials for non-European Community investors.

Canada

Under the formal screening procedures of the Investment Canada Act, Canada's principal mechanism for regulating investment, investments are reviewed for "net benefit to Canada." In the screening process, Canada also considers any performance conditions (such as export or local content commitments) that investors offer and these can, in effect, serve as informal preconditions for investment. Given the high value of bilateral U.S.-Canadian trade and investment, the impact of voluntary performance requirements could be significant; however, they are difficult to quantify, especially since they may often entail provisions such as export requirements which are already contemplated in the investor's business plans.

Under the U.S.-Canada Free Trade Agreement, progress was made in reducing Canada's use of formal performance requirements and in raising its threshold for screening. As a result, 90 percent of foreign investments by number of transactions will be deregulated, but acquisitions of an estimated two-thirds to three-quarters of Canadian assets by value will still be subject to review, according to U.S. government estimates. Thus, the potential exists for continued voluntary performance requirements for foreign investments that will still be subject to screening. It is not clear what impact such informal restrictions will have on U.S. business—with the removal of tariff barriers to U.S. exports under the Free Trade Agreement, costly informal investment barriers could lead American firms to substitute exports to Canada for investment in Canada.

Comparison of G-7 Practices with Provisions of the Foreign Ownership Disclosure Act

The proposed Foreign Ownership Disclosure Act of 1989 (S.289) would provide new authority for detailed reporting by foreign investors, including establishment of a registry for foreign direct investment and access to data for authorized Commerce officials, congressional committees or subcommittees, GAO officials, designated agency officials, and qualified researchers. We compared the provisions of S.289 to the G-7 countries' reporting and disclosure requirements described in the Treasury report.

Germany, Italy, and the United Kingdom have no registries. France maintains a registry, but it is closely held within the government.

Canada monitors investments under the Investment Canada Act and requires detailed reporting. It publishes a list of foreign direct investments, but does not include financial information or sensitive data. Under the Corporations and Labor Unions Returns Act, the ownership of issued share capital of all Canadian corporations is publicly available but balance sheet data are not, according to Treasury.

Japan monitors foreign direct investment and will make limited information available on individual transactions unless the parties request confidentiality. Foreign corporations are included in a publicly available list of all publicly listed corporations.

The Treasury report does not describe the specific data elements required by foreign governments as part of their formal investment processes and, thus, does not provide a basis for the comparison to S.289 that you requested. Complete information on specific data requirements is not readily available. In France and Japan, for example, the formal approval process can entail the supply of data through numerous meetings and exchanges of correspondence, in addition to filing required forms.

Objectives, Scope, and Methodology

We examined the documents used by Treasury in preparing its report and talked with officials responsible for investment and country-specific matters from the Departments of Commerce and State and the Office of the U.S. Trade Representative. We also examined documents of the Organization for Economic Cooperation and Development relating to foreign investment issues and reviewed available private sector studies on this issue. However, we did not verify every individual item in the Treasury report. Our work was conducted in accordance with generally accepted government auditing standards.

As you requested, we did not obtain official agency comments on this report. However, we obtained the views of directly responsible officials during the course of our work and incorporated their comments where appropriate.

Unless you publicly announce its contents earlier, no further distribution of this report will be made until 14 days from its issue date. At that time, we will provide copies to other interested parties. This report was prepared under the direction of Allan I. Mendelowitz, who can be reached on (202) 275-4812. Other major contributors to this report are listed in appendix I.

Sincerely yours,

A handwritten signature in black ink that reads "Frank C. Conahan". The signature is written in a cursive style with a large initial 'F' and 'C'.

Frank C. Conahan
Assistant Comptroller General

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